Based on pages 201-210 textbook

1. What are the major characteristics of pure monopoly?

A pure monopolist is the only seller of a product for which there are no close substitutes. To maintain this position as the sole seller of a unique product, there must be barriers to entry. Also, the monopolist has “price making” power because the monopolist *is* the industry and supplies the entire market for the product. Given a downsloping demand for the product, the monopolist must decrease price to increase quantity sold. Finally, advertising under pure monopoly often depends on the nature of the product and whether the monopolist feels there is a need to increase demand for the product. [text: E p. 202; MI p. 202]

1. What are the major barriers to entry that explain the existence of monopoly?

There are at least four types of entry barriers that create the conditions for pure monopoly. First, economies of scale means that in some industries large-scale production is necessary to achieve the most efficient level of production. In this case, the long-run average cost curve will tend to decline over a wide range of output for a product. Either a few firms, or in the extreme, one firm, will be necessary to provide market demand in the most efficient way. In the extreme, there are natural monopolies that arise when competition between firms is simply inefficient or impractical. The best examples of natural monopolies are public utilities, which are given the exclusive right by government to provide the utility services. Second, the government can restrict entry into a market by granting patents and licenses. A patent gives exclusive production rights to a firm for twenty years. Licenses limit entry into a business or an occupation. Third, pure monopoly arises when a firm has complete ownership of an essential resource, such as aluminum or copper. Fourth, there are pricing or strategic barriers to entry. [text: E pp. 202-204; MI pp. 202-204]

1. Why is marginal revenue less than price for every level of output except the first?

The monopolist is the industry, so its demand curve slopes downward. To increase sales, the monopolist must lower price. The price decreases apply not to the additional quantity sold, but also to all other units of output which otherwise would have been sold at a higher price. As each extra unit of output is sold, it will contribute to total revenue its price less the sum of the price decreases that apply to all prior units of output sold. [text: E pp. 205-206; MI pp. 205-206]

1. A pure monopolist determines that at the current level of output the marginal cost of production is $2.00, average variable costs are $2.75, and average total costs are $2.95. The marginal revenue is $2.75. What would you recommend that the monopolist do to maximize profits?

Marginal revenue is greater than marginal cost at the current level of output. The monopolist should increase output to where marginal costs equal marginal revenue. [text: E pp. 207-208; MI pp. 207-208]

5. A pure monopolist sells output for $4.00 per unit at the current level of production. At this level of output, the marginal cost is $3.00, average variable costs are $3.75, and average total costs are $4.25. The marginal revenue is $3.00. What is the short-run condition for the monopolist and what output changes would you recommend?

The monopolist should make no change in the level of output because the marginal costs equal the marginal revenue at the current level of output. However, the monopolist is experiencing short-run losses because average total cost is greater than the price (average revenue). In the long run, the monopolist may want to try to shift the demand curve so that price is greater than average total cost at the current level of production. The monopolist may also want to find ways to reduce average costs. [text: E pp. 207-208; MI pp. 207-208]